

REPORT OF THE AUDITOR-GENERAL TO THE PROVINCIAL LEGISLATURE AND COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF UKHAHLAMBA DISTRICT MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2008

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Ukhahlamba District Municipality which comprise the, statement of financial position as at 30 June 2008 statement of financial performance, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

Responsibility of the accounting officer for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting determined by the National Treasury, as set out in accounting policy note 1.1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). This responsibility includes:
 - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
 - selecting and applying appropriate accounting policies
 - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

(PAA section 4; ISA 700.32, .34, .37, .38; PFMA section 40(2); MFMA section 126(3))

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance on whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

6. An audit also includes evaluating the:
- appropriateness of accounting policies used
 - reasonableness of accounting estimates made by management
 - overall presentation of the financial statements.
7. Paragraph 11 *et seq.* of the Statement of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by the Ukhahlamba District Municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.
8. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis of accounting

9. The municipality's policy is to prepare financial statements on the basis of accounting determined by the National Treasury, as set out in accounting policy note 1.1.

Basis for qualified opinion

Property, plant and equipment

10. *GAMAP 17: Property, Plant and Equipment* prescribes that where an asset is acquired at no cost, or for a nominal cost, its cost is its fair value as at the date of acquisition.

On 1 July 2006 the municipality assumed responsibility for the provision of water and sanitation services in its district in terms of Government Notice 849 issued in terms of section 84(3)(a) of the Municipal Structures Act, 1998 (Act No.117 of 1998).

In terms of this notice, the water and infrastructure assets of local municipalities within the district were transferred to the District Municipality. The municipality engaged the services of a consulting engineer to determine the recognition value of these assets on the date of transfer. These valuations were used as a basis of recording these infrastructure assets in the asset register and the annual financial statements.

The engineer's working papers reflect that an estimated depreciated cost and not fair value, as prescribed by *GAMAP 17*, was calculated for each asset.

As a result the gain on assets, accumulated depreciation and depreciation as well as government grant reserve is misstated by the difference between estimated depreciated cost and fair value. A limitation of scope imposed by management on the audit fee to calculate the fair value based on estimated replacement cost less depreciation results in an unquantifiable difference.

Trade Payables

11. Due to lack of information, I could not confirm the valuation and allocation of trade payables amounting to R11 571 612. Alternative audit procedures could not be performed to confirm that the liability exists at year-end.

Other reporting matters

12. In terms of section 125(1)(c) of the MFMA, mandatory disclosure includes audit fees, taxes, levies, duties and pension and medical aid contributions. Only VAT is disclosed in note 32.2. The nature and extent of the non-disclosure could not be quantified as management information was not presented for audit purposes.

Accumulated surplus (VAT prior period error allocated to expenditure)

13. The VAT control account was adjusted by R4,9 million as a result of an audit finding and the contra entry was allocated to the opening balance of accumulated surplus. An analysis of the specific disallowed invoices was provided by SARS but, it was not possible to determine whether they related to property, plant and equipment or expenditure. I could therefore not determine the correctness of the entry against the accumulated surplus.

Qualified opinion

14. In my opinion, except for the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Ukhahlamba District Municipality as at 30 June 2008 and its financial performance and cash flows for the year then ended, in accordance with the basis of accounting as set out in accounting policy note 1.1 and in the manner required by the MFMA.

Emphasis of matters

I draw attention to the following matters:

Highlighting critically important matters presented or disclosed in the financial statements

Unauthorised, irregular or fruitless and wasteful expenditure as well as material losses through criminal conduct

15. An unauthorised expenditure totalling R59,9 million has been disclosed under note 31.1 to the annual financial statements and has not yet been approved by the council. It should furthermore be noted that the comparative amount was restated by R42, 7 million as prior year unauthorised expenditure not recognised.

Restatement of corresponding figures

16. As disclosed in note 25, 26 and 27 to the financial statements, the corresponding figures have been restated as a result of an error discovered during the 2007-08 financial year in the financial statements of Ukhahlamba District Municipality. The restatements

affected a significant amount of account balances and I highlight the following as it should be considered as unusual items as a result of either first time recognition or material adjustments to account balances that was not previously identified and reported on:

- (i) The recognition of infrastructure assets to the value of R140 million materially affected the account balances of property, plant and equipment as well as the government grant reserve.
- (ii) The accumulated surplus also reflects material restatements relating to roads subsidies (R22 million), VAT (R4,9 million) and water service provider balances (R5,6 million).
- (iii) The recognition of intangible assets (R3,3 million) not previously recognized should be highlighted along with the impairment (R2,9 million) thereof.
- (iv) An adjustment to investments of R5,6 million raises concerns as this bank balance was not previously recognized and disclosed.

OTHER MATTERS

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Internal controls

17. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the inefficiencies in the system of internal control, which led to the adverse opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Property, plant and equipment					✓
Payables					✓
Receivables					✓
Mandatory disclosure notes					✓
VAT					✓

Control environment: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.

Risk assessment: involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.

Control activities: policies, procedures and practices that ensure that management's financial reporting

Reporting Item	Control Environment	Risk Assessment	Control Activities	Information and Communication	Monitoring
<p>objectives are achieved and financial reporting risk mitigation strategies are carried out.</p> <p><u>Information and communication</u>: supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allows people to carry out their financial reporting duties.</p> <p><u>Monitoring</u>: covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.</p>					

Non-compliance with applicable legislation

Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA).

18. The audit committee was not constituted as required by section 166(4)(a) as it did not consist of 3 members for the full duration of the year and did not meet at least 4 times as required by section 166(4)(b).
19. Evidence that council adhered to the requirements of section 32(2)(a)(ii) of the MFMA relating to unauthorised expenditure could not be obtained.
20. The municipality does not comply with section 75 as information regarding long term borrowing contracts, section 33 contracts and quarterly reports are not published on the website.
21. Evidence that all the prior period report items received attention as envisaged in section 131(1) could not be obtained.
22. The municipality did not comply with section 72 as the mid-year reports did not contain financial information.
23. All payments of creditors were not exercised within 30 days as defined in section 65(2)(e).

Municipal Systems Act (Act No. 32 of 2000)

24. The internal audit plan did not make provision for the auditing of performance measures as defined in section 165(2)(b)(v) read with section 45(a) of the Municipal Systems Act.

Matters of governance

25. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

Matter of governance	Yes	No
Audit committee		
<ul style="list-style-type: none"> The municipality had an audit committee in operation throughout the financial year. 	✓	

Matter of governance	Yes	No
<ul style="list-style-type: none"> The audit committee operates in accordance with approved, written terms of reference. 	✓	
<ul style="list-style-type: none"> The audit committee substantially fulfilled its responsibilities for the year, as set out in Section 166(2) of the MFMA. 		✓
Internal audit		
<ul style="list-style-type: none"> The municipality had an internal audit function in operation throughout the financial year. 	✓	
<ul style="list-style-type: none"> The internal audit function operates in terms of an approved internal audit plan. 	✓	
<ul style="list-style-type: none"> The internal audit function substantially fulfilled its responsibilities for the year, as set out in Section 165(2) of the MFMA. 		✓
Other matters of governance		
<ul style="list-style-type: none"> The annual financial statements were submitted for audit as per the legislated deadlines in section 126 of the MFMA. 		✓
<ul style="list-style-type: none"> The annual report was submitted to the auditor for consideration prior to the date of the auditor's report. 		✓
<ul style="list-style-type: none"> The financial statements submitted for audit were not subject to any material amendments resulting from the audit. 		✓
<ul style="list-style-type: none"> No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management. 		✓
<ul style="list-style-type: none"> The prior year's external audit recommendations have been substantially implemented. 	✓	
Implementation of Standards of Generally Recognised Accounting Practice (GRAP)		
<ul style="list-style-type: none"> The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 30 October 2007. 		✓
<ul style="list-style-type: none"> The municipality substantially complied with the implementation plan it submitted to the National Treasury and the relevant provincial treasury before 30 October 2007, detailing its progress towards full compliance with GRAP. 	✓	
<ul style="list-style-type: none"> The municipality submitted an implementation plan, detailing further progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 31 March 2008. 		✓

OTHER REPORTING RESPONSIBILITIES

REPORT ON PERFORMANCE INFORMATION

26. I have audited the performance information as set out on pages xx to xx.

Responsibility of the accounting officer for the performance information

27. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

Responsibility of the Auditor-General

28. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.
29. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
30. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings (performance information)

Non-compliance with regulatory requirements

Content of integrated development plan

31. The integrated development plan of the Ukhahlamba District Municipality did not reflect a financial plan which included budget projects for at least the next three years as required by Section 26 of the MSA.
32. The municipality did not, within 14 days after the adoption of the IDP, notify the public of the adoption of the IDP and that copies of or extracts from the plan are available for public inspection at specified places; and did not publicise a summary of the plan, as required by section 25(4) of the MSA.

Performance management system

33. The key performance indicators, the measurable performance targets, monitoring and review performance were not determined in terms of the performance management system, as required by section 41 of the MSA.
34. The municipality did not develop and implement a performance management system, as required by Section 7 and 8 of the Local Government: Municipal Planning and Performance Management Regulations, 2001 (GNR 796 of 2001) and sections 38 to 42 of the MSA.
35. The municipality did not assess the performance of the municipality during the first half of the year, based on the objectives/priorities included in the integrated development plan, as required by section 72 of the MSA.
36. The municipality did not prepare performance reports for the period under review based on the objectives/priorities included in the integrated development plan, as required by section 46 of the MSA.

Measurable objectives and/or indicators and/or targets not consistent

37. Sufficient and appropriate audit evidence in relation to the performance information of the municipality could not be verified as the objectives included in the IDP are

inconsistent with the information included in the performance report provided for audit purposes. It could thus not be confirmed whether the municipality adequately monitored and evaluated its predetermined objectives as per the IDP.

Lack of sufficient appropriate audit evidence

- 38. As a result of the non inclusion of key performance indicators and targets in the integrated development plan the quality and measurability of the development objectives/priorities could not be verified.
- 39. The development objectives/priorities included in the integrated development plan were not included in the budget and the performance report, therefore the consistency of objectives/ development priorities between the aforementioned documents could not be verified.

OTHER REPORTS

Investigations

- 40. A special investigation into alleged fraud risks were requested by management. The findings of this investigation have not been published at the date of writing this report but may have an influence on the financial position and results as disclosed in the financial statements.

APPRECIATION

- 41. The assistance rendered by the staff of the Ukhahlamba District Municipality during the audit is sincerely appreciated.

Auditor - General

East London

15 April 2009



A U D I T O R - G E N E R A L